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WILLIAM A. MUNDELL
Chairman

JIM IRVIN
Commissioner

MARC SPITZER
Commissioner

IN THE MATTER OF ARIZONA PUBLIC SERVICE COMPANY'S REQUEST FOR A VARIANCE OF CERTAIN REQUIREMENTS OF A.A.C. R14-2-1606	DOCKET NO. E-01345A-01-0822

REPLY OF ARIZONA PUBLIC SERVICE COMPANY TO RESPONSE OF COMMISSION STAFF

Arizona Public Service Company ("APS" or "Company") is appreciative of receiving the Utilities Division Staff ("Staff") Response in the above captioned proceeding, and the Company agrees with the need to collaboratively establish a prompt schedule for the Commission's consideration of the APS request. But APS is seriously concerned that the Response represents an unwarranted and potentially dangerous pre-judgment of the Company's application prior to receiving responses to a single Staff data request, prior to any meetings with APS to discuss the filing and prior to any in-depth internal Staff analysis. Just as troublesome are the Staff's statements concerning the intent and scope of the October 18th filing by the Company and Staff's proposed solution – an exhaustive re-examination of retail electric competition in Arizona, including both the APS and Tucson Electric Power Company ("TEP") 1999 rate settlements. And although APS does interpret the Response as essentially a motion for a procedural order and scheduling conference, requests with which it agrees, APS finds itself compelled to address both Staff's statements concerning the Company's filing and the overly broad solution suggested by Staff.

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I.
INTRODUCTION

APS' filing responsibly addressed several critical issues facing the Company, its customers and the Commission, namely:

1. the obligation of incumbent utility distribution companies ("UDC's") such as APS to provide reliable electric service to Standard Offer customers after 2002;

2. the significant short-term and long-term investments and other efforts made by APS and its affiliates to meet this obligation;

3. the need for retail rate stability amidst a volatile and unpredictable wholesale electric market;

4. the ability of the current wholesale generation market to support a viable competitive bidding process of the magnitude envisioned by Rule 1606 (B); and,

5. the potential for a California-type debacle of large rate increases, financial peril for incumbent UDC's, supply constraints and resultant customer dissatisfaction.

APS is extremely disappointed that Staff's Response either ignores or hastily dismisses these significant concerns.

APS sought only a variance to one subsection of one of the Arizona Corporation Commission's 17 electric competition rules. It did not seek exemption from the rule, as has been granted the co-operatives by the Commission and public power entities by the Legislature. It did not seek a complete waiver of the rule as has been previously granted to Citizens Communications Company. The Company's request is specifically authorized by A.A.C. R14-2-1614 (C). Moreover, even under its proposal, APS would be competitively bidding for more generation by 2008 than any other Arizona UDC.

The proposed purchased power agreement ("PPA") represents the commitment to APS of Pinnacle West Energy Corporation ("PWEC") resources at essentially cost-of-service. PWEC was under no legal obligation to make such a commitment under

either terms of the 1999 rate settlement or the Commission's Electric Competition Rules. In addition to cost-based rates, the PPA between APS and Pinnacle West Capital Corporation ("PWCC") provides stability and reliability not obtainable from the competitive wholesale market, and provides ample opportunities for non-affiliated generators to participate in both serving APS customers and the broader Southwest power market. Although APS certainly expects the Commission to carefully scrutinize the PPA, it believes that dismissing the PPA out-of-hand, underestimating the importance of reliability or assuming as of yet unproven impacts on the wholesale competitive market are clearly premature conclusions that will inevitably lead to the adoption of unwise policies.

II.
APS SUPPORTS ISSUING A PROCEDURAL ORDER AND/OR HOLDING A PROCEDURAL CONFERENCE FOR THE TIMELY CONSIDERATION OF THE COMPANY'S REQUEST

APS agrees that an evidentiary hearing or other proceeding on the Company's request (and only the Company's request) be scheduled as quickly as possible through the issuance by the Hearing Division of a Procedural Order that will allow a prompt Commission decision. If this necessitates the pre-filing of written testimony, then a schedule for the filing of all such testimony (including Staff's and intervenors), as well as associated dates for intervention and hearing should be set consistent with Staff's suggestion that APS provide direct testimony by December 7, 2001. Alternatively, the Hearing Division could order an immediate scheduling conference to attempt to work out an agreed-upon set of procedural dates prior to issuance of its final procedural schedule. There is simply no legitimate reason to require only the Company to file its testimony and then "meet and confer" on the balance of the procedural schedule as Staff has suggested in its Response.

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III.
STAFF'S REQUEST FOR AN ORDER PROHIBITING THE TRANSFER OF APS GENERATION TO PWEC IS UNNECESSARY AND UNLAWFUL

Staff's request for some sort of preliminary "injunction" against the transfer of APS generating assets as required by the Electric Competition Rules and as authorized by Decision No. 61973 (October 6, 1999) is a material violation of the 1999 APS settlement agreement. The Commission's own Electric Competition Rules, as modified by the Commission pursuant to A.A.C. R14-2-1614 (C) in Decision No 61973, order APS to transfer its generation by the end of 2002 subject only to one precondition set forth in A.A.C. R14-2-1609 (I). APS has already satisfied that precondition pursuant to FERC-approved ancillary services (including must-run) agreements with PWEC and PWCC. Decision No. 61973 independently authorized the transfer of such assets pursuant to A.R.S. § 40-285 subject only to the submission of 30-days notice in conformance with the requirements set forth at page 10 of such Decision.

Although APS believes (and the Arizona Court of Appeals has found) that the entry of Decision No. 61973 formed a binding settlement agreement between the Commission and the Company on the subject of divestiture, one does not have to accept that view to reject Staff's highly improper request. Under any interpretation of Decision No. 61973, it is a valid Commission order until such time as it is set aside by a court of competent jurisdiction. Even if subsequently determined by the Arizona Supreme Court as not being such a binding contract, Decision No. 61973 could only then be amended in accordance with the provisions of A.R.S. § 40-252, which require that APS be afforded notice and hearing prior to any adverse amendment to its terms. Failure to afford an affected party a hearing required by statute is *per se* unlawful. *Southern Pacific Transportation Company v. Arizona Corporation Commission*, 173 Ariz. 630, 845 P.2d 1125 (App. 1992). Staff's Response seeks summary action by the

Commission without any mention of either the Company's rights under the settlement agreement or pursuant to statute.

Staff's request for a summary order blocking divestiture is as unnecessary as it is improper. At page 2 of its Response, Staff states: "The analysis of the PPA may yield different results if it takes place in an environment where the generation assets are no longer under the Commission's jurisdiction." Although APS submits that the referenced "analysis" of the PPA should be unaffected by the legal ownership of generating assets devoted to that agreement, the statement ignores the fact that the PPA cannot take effect until after divestiture (PPA, Section 11.1) and that divestiture is clearly not anticipated until after the variance has been granted and the PPA has received Commission approval. *Id.* To that end, APS (at Staff's specific request) filed a letter in this Docket explicitly stating that the October 18th filing was not the 30-day notice required by Decision No. 61973. *See* attached copy of letter to Commission counsel dated November 8, 2001.

The November 8 letter was provided the Commission specifically to avoid the sort of precipitous Commission action now urged by Staff. Any Commission order forcibly blocking APS divestiture, no matter how temporary or how couched with language recognizing the primacy of Decision No. 61973, will assuredly result in a significant and adverse reaction in the financial community. It will signal a clear intent to unilaterally and unlawfully abrogate the 1999 settlement. As the Commission no doubt recalls, the last time the market became fearful of such a reopening of the Company's prior rate settlement with the Commission (an incorrect assessment, as it turned out), the resultant loss in market value to the Company's shareholders was significant and immediate - over 100 million dollars in less than a week.

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IV.
THE COMPANY'S REQUEST DOES NOT SEEK A CHANGE IN THE 1999 APS RATE SETTLEMENT AGREEMENT

A. Sections 4.1.3 and 7.8

It is Staff's Response, not the Company's October filing, that seeks to improperly change the 1999 settlement. Staff's Response contends that the Company somehow seeks to alter Section 4.1.3 of the 1999 APS rate settlement agreement, approved with modifications in Decision No. 61973, or that the October filing represents a difference in interpretation of that provision by the parties that requires the signatories of the settlement to "meet and confer" pursuant to Section 7.8 of the agreement. *See* Response at page 4, lines 21-22; page 6, lines 24 – 26; and page 7 lines 15 –18. However, neither Section 4.1.3 (which was not in the original settlement and was requested by a non-party to the settlement, Enron Energy Services during the Commission's deliberations on the agreement) nor Section 7.8 explicitly incorporate the competitive bidding requirement of Rule 1606 (B).[1] The former merely commits APS to follow the Electric Competition Rules as regards Standard Offer procurement, which rules expressly permit requests for variances. Indeed, the Commission has already granted several variances to Electric Competition Rules, at least one of which was also a subject area of the 1999 APS settlement – and without there even being a request on file. *See*, e.g., Decision No. 63354 (February 8, 2001) – APS and other Affected Utilities relieved of the obligation to divest a portion of their generation.

[1] The latter provision (Section 7.8) of the APS settlement is only triggered when APS becomes aware of a disagreement with another party to the settlement (which would not include Staff) over its interpretation. APS was not and is not aware of any such disagreement and has received no request from a party to the settlement for a conference, but will fully comply with its obligation to meet and confer whenever requested to do so.

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B. WestConnect

Although entirely unrelated to the October 18th request for variance, Staff also raises the issue of WestConnect as being somehow contrary to the 1999 APS settlement and the Electric Competition Rules.[2] *See* Response at page 4, lines 25 –28; page 6, line 28 – page 7, line 2. This concern is as inexplicable as it is unmerited. With the Commission's full knowledge, the Company has expended substantial resources in both time and money in its leadership role in forming first Desert Star and then its successor organization, WestConnect.

Rule 1609 (C) of the Electric Competition Rules clearly does not require that the RTO must be the then contemplated "Desert Star." In fact, it does not even mention "Desert Star" as such. As to the reference to Desert Star in Section 7.6 of the APS settlement, it is merely intended as a generic reference to an RTO or ISO, since FERC would have the final say as to the structure of any such organization irrespective of the agreement or the wishes of the parties to that agreement, including the Commission. If any parties to the agreement now contend that Section 7.6 is tied to a specific name or a specific organization rather than to a concept (a "FERC-approved RTO or ISO" in the parlance of Rule 1609), APS will again offer to meet and confer with such parties.

Aside from its lack of relevance to the October filing or its relationship (or lack thereof) to the 1999 APS settlement and the Electric Competition Rules, APS was astounded by Staff's apparent opposition to WestConnect. Although long aware of this alternative and public proposal to the moribund Desert Star (first proposed not by APS, but by El Paso Electric Company), Staff has never indicated so much as a word of opposition to the WestConnect concept, which draws heavily on the protocols

[2] APS does not know why Staff apparently believes this. Is it because WestConnect does not use the name "Desert Star" or because Staff does not consider West Connect to be a "Regional Transmission Organization" within the meaning of Rule 1609? The Response is silent.

developed for Desert Star. Even during face-to-face meetings with Staff during this past summer, APS received no negative comments on or objections to WestConnect.

V.
STAFF'S RESPONSE UNFAIRLY CRITICIZES APS' FILING FOR NOT PRESENTING DETAILED EVIDENTIARY SUPPORT RESPECTING THE REQUESTED VARIANCE

Staff's Response devotes an entire section to the proposition that "APS HAS NOT PROVIDED ANY SUPPORT FOR ITS REQUEST." *See* Response at pages 5 and 6. The Company filed precisely what is required by A.A.C. R14-2-1614 (C). Although many of the assertions by APS in the October filing are, in its opinion, self-evident (e.g., the volatility of the wholesale market, the failure of the Electric Competition Rules to address supply reliability, and the significant rate increases and reliability problems experienced in California and else where during the past 18 months), the Company will address relevant evidentiary issues raised by Staff in whatever forum (evidentiary hearings, Open Meeting, etc.) the Commission finds appropriate for the consideration of the APS request.

Curiously, Staff provides no support of its own for the statements in the Response that the "APS Request has far reaching implications in connection with the Commission's attempts to restructure the electric utility industry in Arizona" (*Id.* at page 1); that "circumstances have clearly changed since the Commission adopted the Electric Competition Rules" (*Id.* at page 2); that "competitive bidding is an integral part of the development of the restructured electric generation market" (*Id.* at page 3); that "the term of the PPA would ensure that no competitive electric generation market could develop in Arizona for the next 15 years" (*Id.* at page 4 – emphasis supplied); that the

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PPA "would probably act to stifle any possibility of a competitive generation market developing anywhere in the state" (*Id.* at page 5 – emphasis supplied); or that "[T]he APS Request is in contravention of every objective of the Commission's Electric Competition Rules, as well as the APS Settlement" (*Id.* at page 3 – emphasis supplied). Other than agreeing with Staff's apparent belief that the generation market in the West is not mature enough to support a Rule 1606-size bidding requirement in 2003 (which was a primary reason for the Company's October 18th filing), APS does not believe Staff's sweeping assertions are correct or even address the relevant public interest issues relating to customer service and the development of a competitive market. APS therefore welcomes the opportunity to test these and other allegations made in the Response in the appropriate forum of the Commission's choosing.

VI.
ANY PROCEEDING ON THE OCTOBER FILING SHOULD NOT ENCOMPASS A COMPLETE RE-EXAMINATION OF THE ELECTRIC COMPETITION RULES AND THE APS OR TEP SETTLEMENTS

APS' request for a variance to Rule 1606 (B) and approval of the proposed PPA deserve to be considered on their own merits and in a timely fashion. APS and its affiliates are investing well over a billion dollars to meet the present and future needs of APS customers and have taken a variety of responsible short-term measures to provide reliable electric service during the summer season. The Commission-ordered transfer of the great bulk of the Company's generation assets and the related and necessary "buy-back" of power memorialized in the PPA is an integral part of these plans and must be acted upon as soon as possible (preferably by year's end) and certainly well before the December 31, 2002 deadline. If the Commission will not

recognize the Company's commitment to reliably serve its customers, then the Company needs to make immediate alternative arrangements to sell power elsewhere, review the status of existing projects, redeploy capital and revise long-term plans.

This timetable cannot be reconciled with Staff's proposal to do a comprehensive "Mulligan" on the entire scope of the Electric Competition Rules or by attempting to unilaterally abrogate or renegotiate the APS, let alone the TEP, settlement in the context of this proceeding. The first go round on the Electric Competition Rules alone lasted from 1994 through the end of 1996.

If Staff seeks to amend the Electric Competition Rules, there both is a procedure and form of proceeding for such amendment set forth in the Arizona Administrative Procedure Act. Attempting to introduce collateral issues into the APS October filing is not the appropriate procedure, and this Docket is not the appropriate proceeding.

As noted in the INTRODUCTION, APS seeks only a variance to one of nine subsections from one of 17 of the Commission's Electric Competition Rules. It is less a variance of Rule 1606 (B) than has already been granted by the Commission to all the other Affected Utilities excepting TEP, and one that will still leave APS as the undisputed Arizona leader in the acquisition of competitively-bid generation for Standard Offer service. This is hardly be the cause of the sweeping proceeding envisioned by Staff, and using the October filing as pretext to such a omnibus proceeding does a disservice to the very "adequate, thoughtful and fair consideration of the request" suggested by Staff on the first page of its Response.

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VII.
CONCLUSION

APS asks only that Staff and the Commission give its request fair consideration. The Company believes nothing less than the continued reliability and price stability of Standard Offer service is at stake, and Staff certainly has not proposed any alternative to the proposed PPA other than continued reliance on Rule 1606 (B). Without the availability of a viable, reliable and reasonably-priced Standard Offer service to keep the competitive ESP's on their toes, most of APS' customers will find the promise of competition unfilled at best, or replaced by the nightmare of California at worst.

APS asks the Commission to reject Staff's improper and unnecessary request for an order prohibiting, even on an interim basis, the transfer of generation required by the Electric Competition Rules and authorized by Decision No. 61973. APS further asks that proceedings on the Company's request be scheduled as quickly as possible by prompt issuance of a comprehensive procedural order as discussed above, or alternatively, the Hearing Division could order an immediate scheduling conference to attempt to work out an agreed-upon set of procedural dates.

RESPECTFULLY SUBMITTED this 26th day of November, 2001.

SNELL & WILMER L.L.P.

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November 8, 2001

HAND-DELIVERED
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Legal Division
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Re: *Docket No. E-01345A-01-0822*

Dear Ms. Alward:

In response to your inquiry of November 7, 2001 concerning the Application of October 18, 2001, let me make the following statements on behalf of Arizona Public Service Company ("APS") or "Company"):

1. APS fully intends to transfer to an affiliate or affiliates all of its non-renewable generating assets as authorized by Decision No. 61973 and as required by A.A.C. R14-2-1615, prior to December 31, 2002.

2. Decision No. 61973 requires APS to provide the Arizona Corporation Commission ("Commission") with 30-days prior notice of the transfer of any of the Company's generating assets in the form specified at page 10 of that Decision.

3. The Company's October 18, 2001 filing in the above Docket was not nor was it intended to be the 30-day notice described in Decision No. 61973.

I hope this has removed any doubt in the Commission's mind as to both the Company's intentions and the legal import of the October 18th filing.

Very truly yours,

SNELL & WILMER L.L.P.

Thomas L. Mumaw

Thomas L. Mumaw
Attorneys for Arizona Public Service Company

cc: Docket Control

1093796.1

CERTIFICATE OF SERVICE

The original and ten (10) copies of the foregoing document were filed with the Arizona Corporation Commission this 26th day of November, 2001, and service was completed by mailing, e-mailing, or hand-delivering a copy of the foregoing document this 26th day of November, 2001, to all parties of record herein.

Judith Y. Borrego

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